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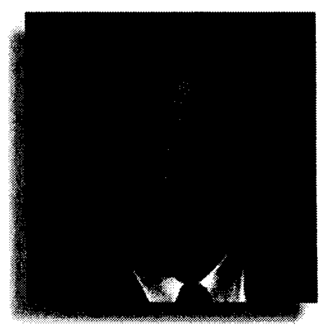
DAVID BRUNORI'S TAX TALK

Sticking to Principles

There comes a time in the life of every tax system when it needs to be reassessed to see if it's doing the job it's been sent out to do.

Are we thinking about the principles of sound tax policy this legislative season? Probably not. Most of us think about "good tax policy" as often as we think of stuffed cabbage. Probably less often. Except that this year could be different. The multibillion-dollar budget deficits pose a problem for those governors and legislators who won election by promising never, ever to raise taxes. Their first thoughts are likely to be about spending cuts. For really big savings, they could close the state university. That would solve the fiscal crisis without raising taxes. But most politicians don't really want to do that. Shutdowns are, well, not conducive to reelection.



Perhaps the problem is not so much with raising taxes as with reforming a system that, in the modern economy, is not designed to bring in enough revenue. Public finance experts have long lamented the structural deficit and the need for legislators and other policy makers to take a more positive attitude toward taxes — at least in principle. If you are at all interested in state tax policy, you should read a slim volume published by the National Conference of State Legislatures called, aptly enough, "Principles of a High Quality Tax System." This work, available for free on the NCSL Web site, was put together in 1992 with the advice from the leading public finance scholars and reflects what has long been thought of as "good tax policy."

It would be nice if folks formulating fiscal policy measured every tax proposal that comes across their desk against the principles set forth in the NCSL work. They are surprisingly simple. One, for example, is that the tax system should be designed to raise the revenue necessary to pay for services demanded by citizens — good schools, safe streets. Another is that tax systems should be neutral. That is, they should have as little effect as possible on a citizen's economic decision making — whether to invest or save money or make a purchase. American lawmakers, of course, use the tax laws to try to influence behavior all the time. They tax cigarettes and other sinful products to deter their use. They provide tax breaks to folks to encourage them to get married (how romantic!) and have children (how responsible!). They give tax breaks to companies that promise to locate in their state, to companies that promise not to leave their state, and sometimes even to companies that were going to move into their state even without the tax benefits. And of course they offer tax breaks to companies that make campaign contributions to politicians who decide who gets the tax breaks. Not everyone gets these breaks, of course. The governor of my state of Virginia would not give me a dime to stay put.

A good tax system should also be fair. Now for most people, fairness comes down to this: If you pay the tax, it's fair. If I pay the tax, it's unfair. Fairness is usually thought of in the excruciating language of horizontal and vertical equity. Horizontal equity means that similarly situated people should be taxed similarly. Jack earns $15,000 a year mopping floors at a convenience store, and Jill earns $15,000 in dividends while enjoying bonbons on her couch. A lot of governments will tax Jack, but not Jill.

Vertical equity is often discussed in terms of one's ability to pay. We often use fancy terms such as progressivity and regressivity to describe whether the poor or rich are paying too much or not enough. All of the rich folks think they are paying too much. And the poor folks have no idea what they're paying. Progressive taxation occurs when we soak the rich in an envy-frenzy to redistribute wealth. Regressive taxation occurs when we ask the poor and dispossessed to pay for the roads on which rich folks drive their fancy cars. State taxes tend to be more regressive than progressive due largely to their heavy reliance on consumption taxes. The bottom line is that in most states, the guy serving drinks at the country club pays a greater percentage of his income in taxes than the wealthy golfer he serves.

There are other principles that should be considered when formulating tax policy. Tax systems should be efficient, economical, and accountable. The states satisfy some and fail miserably in others. Can the state tax systems be reformed to adhere more closely to these long recognized guidelines? Of course they can. But that means policy makers have to do more than just avoid the T-word and consider, regardless of political philosophy, the fine art of revenue-raising an honorable and necessary part of governing. After all, even the most anti-tax politicians want someone to answer when they dial 911.

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